HISTORY OF BANK INDONESIA : BANKING
Period from 1999-2005

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1. Highlights

As the crisis passed, BI truly learned valuable experience to strengthen its supervision. This was backed up by the issuance of Bank Indonesia Act of 1999 that granted the bank independence and greater authority in supervising banks in the country. To do so, BI improved its internal banking regulations and its supervisors' skills. On the completion of banking restructuring programs, all banking credit portfolios were scrutinized. It was discovered that over 70% of bank credits were classified as non-performing and doubtful. These credits were, however, the very credits extended to debtors whose business condition remained sound, even though they were facing difficulty during the 1997 crisis. Based on the finding, a Restructuring Program of Credits particularly for the banks that received financial assistance from the Government through IBRA was then launched. While for the B category and BPD banks, Bank Indonesia provided assistance to mediate between the banks and their debtors through Credit Restructuring Task Force. Likewise, Jakarta Initiative was established to assist other banks and the businessmen who received credits from these banks, especially foreign banks.

One of the banking correctional steps was the more specific and intensified supervision of banks showing signs of difficulty. For the first time in history, On-Site Supervisory Presence, adopting the US banking supervision pattern, was conducted. To date the OSP has been conducted in nine major banks having market share of 75% of the national baking total assets. In this way, BI is able to carry out earlier and continuing supervision on bank development. BI also imposes supervision on possible banking risks in the future. It is compulsory for every bank to enable BI to obtain overall information of the banks' conditions in the future. In line with the Financial Action Task Force agreement, BI initiated the issuance of acts on criminal charges of money laundering. BI also issued a complimentary regulation commonly known as Know Your Customer to comprehensively find out information about bank customers, especially those who carry out banking transactions in huge amounts. BI established the Center for Financial Transaction Research and Analysis.

2. Direction of Banking Policies 1999-2005

In general, the banking policies made during this period were directed towards 4 steps, namely continuing the consolidation process, strengthening the banking infrastructure, stepping up the prudential principles and spurring the banking intermediation role. The efforts to continue the consolidation process were made through bank recapitalization conforming to the criteria of the respective banks.

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In respect to the structure strengthening, the Government issued several policies, among others: the establishment of the Indonesian Deposit Insurance Corporation (LPS) on 22 September 2005, the signing of Memorandum of Understanding between Bank Indonesia, Ministry of Finance and LPS at the end of 2005 regarding the division of the roles and functions in maintaining the financial system stability. This step was also followed by the setting up of the Financial System Stabilizing Forum (FSSK). Meanwhile, the development of banking human resource took place through the risk management certification program for bank management. In terms of banks customers, the Government issued the regulation on the mechanism for the bank customers to convey their grievance and complaints.

To step up the banking prudential principles that referred to the best practices of 25 Basel Core Principles, BI introduced the application of Good Corporate Governance and consolidated bank supervision principles.

In correspond with the efforts to align its intermediation role, the government remained prioritizing the policy to enhance small and medium enterprises. This step was taken by stepping up the role of Small Loan Banks (BPR), commercial banks and sharia banks.

As a result, the bank supervision in this period was focused on banks' sustainability that began with the restoration steps of the banking sector (see attachment).

Attachment:
In general term, the details of the banks supervision program were as follows:

Consolidating the Banking System

Infrastructure Improvement	Application of Good Corporate Governance principles	Improvement of Regulation and Supervision Roles
• Affirmation of financial service authority • Certainty of saving guarantee scheme • Guaranteed funding sources for likely systemic problems in the future. • Development of Small Loan Banks and Sharia Banks. The market segments of both banks are more capable to endure adversity.	• Better screening, Fit & Proper Test for major shareholders & executive officers. • Mandatory position of the Director of Compliance in a bank.	• Strict penalties over any unfit & improper actions • Forging joint efforts in respect to Act Enforcement • Application of International Standards in the bank supervision system

Banking Restoration

Overall Blanket Guarantee Scheme	Recapitulation Program	Credit Restructuring
To restore the public confidence, all the obligations of commercial banks and small loan banks were guaranteed by the Government.	To cope with the solvability issues resulting from the banks' limited capital, the Government introduced a capital participation program to the national private banks, state banks and regional government banks by issuing government bonds.	The borrowings of the recap banks were handed over to IBRA to be restructured and later handed over to the restructured banks. While, the restructuring of non-banks private companies' offshore loans were carried out by the Jakarta Initiative.

In line with the authority to issue monetary policies, Bank Indonesia was given more power in the bank supervision. The authority to grant the business permits for the commercial banks and small loan banks, which formerly held by the Minister of Finance, was transferred to Bank Indonesia. To strengthen the banking supervision role, Bank Indonesia took a number of steps, among others were:

- Prohibiting banks from facilitating any money laundering attempt;
- Mandatory fit and proper test for the majority shareholders and bank management members, for the existing ones and candidates.
- Set up the Banking Investigation Team

- Imposed a scrutiny and intensive supervision of banks which shows early signs of problems;
- Introduced a new pattern of bank supervision by assigning a number of auditors/controllers in the banks under scrutiny for some specified time;
- Mandatory risk-based management for banks with forward looking approach;
- Mandatory good corporate governance principles for banks and so on.

3. Strategic Steps 1999-2005

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As continuation of the banking restructuring program taking place before, throughout this period, BI along with the Government went ahead with the efforts to rehabilitate the banking industry, including its intermediation. These took place through the recapitalization program completion of commercial banks, and continuation loan restructuring, and maintenance of the public confidence in the banking sector through the extension of government's blanket guarantee of the payment obligations of the commercial banks.

To consolidate the banking industry in the future, in the beginning of this period the Government initiated a number of steps to strengthen the banking system. This was accomplished by improving the banking infrastructure and stepping the supervision role, and improving the banking supervision quality known as good corporate governance. In choosing the banking policies during this period, BI did so in view of the agreements already made with a number of international financial institutions, such as International Monetary Fund (IMF)as contained in the Letter of Intent (LoI), World Bank and Asian Development Bank (ADB).

To further back up the consolidation process, infrastructure strengthening, stepping up the prudential principles, and augmenting the banking intermediation role, BI took several steps, among others through:

Recapitalization Program

This program was jointly carried out with the Government, IBRA, House of Representatives and international financial organizations like the World Bank, IMF and ADB. In this matter, the Government played the role as the investor with majority ownership in the banks participating in the recapitalization programs, while the former owners (minority) acted as the accountable parties of the performance of the said banks. Meanwhile, the House of Representatives gave its consent to the Government's capital participation in the banks taking part in the recapitalization program. Meanwhile, international financial institutions acted as the observers that indirectly confirmed the worthiness of such recapitalization program. This recapitalization program agreement was further contained in the IMPA (Investment and Management-Performance Agreement). Within this recapitalization program, IBRA was assigned to maximize the Government's investment in the banks participating in the recapitalization program in such a way that it gave a positive impact to the economic recovery.

Rehabilitating the national banking structure

To create a stable and sustainable banking structure, BI worked closely with the Government to formulate the Indonesian Banking Infrastructure (API). Under this scenario, the banks were obligated to strengthen in capital according to their operation scope. The wider the operation scope, the more capital was required. As a result, small banks which had been vulnerable to the market jolts were encouraged to grow, merge with other banks, be acquired by the other banks or turned themselves to small loan banks. Under this scenario, the banks' operational scope were divided into 4 categories, namely: Banks with Limited Business Activities, Focus Banks, National Banks and International Banks.

Infrastructure Strengthening

In respect to the infrastructure, a number of policies were made along with the Government, among others the establishment of the Saving Guarantee Institution (LPS) on 22 September 2005, the signing of MOU between BI, Minister of Finance and LPS at the end of 2005 regarding the dividing the roles and functions to maintain the stability of financial system. This step was followed by the establishment of the Financial System Stabilizing Forum (FSSK). In the meantime, the banking human resource began with the administering the exam for risk management certification program. From the side of banks customers, BI worked out the mechanism for the bank customers to air their grievance and complaints.

Stepping Up the Intermediation Role

With respect to stepping up the intermediation role, the policy to develop small and medium enterprises remained a priority. This step was taken to increase the role of small loan banks, commercial banks and sharia banks. Meanwhile, BI worked closely with the Government, such as the Ministry of Cooperatives and Development of Small Enterprises to keep paying attention to this sector.

Improving the quality of good corporate governance

Good corporate governance in the banking sector is a management system based upon the principles of transparency, accountability, independence, and fairness. The policies of BI to improve the quality of bank supervision were among others: appointment of the Director of Compliance, mandatory fit & proper test, bank capitalization, application of risk management, transparency of bank financial condition, and guidelines for prudential principles in running the business.

4. Supervision Authority 1999-2005

As regulated under Act No. 23 of 1999 concerning the Central Bank, one of BI's duties is to regulate and supervise the banking sector.

As regulated under Act No. 23 of 1999 concerning the Central Bank, one of BI's duties is to regulate and supervise the banking sector. The scope of this duty includes drafting the regulations, grant and revoke licenses for certain business activities, supervise the banks, and impose penalties against the banks according to the prevailing acts and regulations.

Apart from BI, there are some other institutions that are responsible for supervising the banks, although with limited scope, namely:

- State Audit Agency: authorized to supervise the state banks.
- The Capital Market Supervising Agency (Bapepam): responsible for supervising the banks with public-listed status
- The Center for Financial Transaction Reporting and Analysis (PPATK) that was set up in 2002 (pursuant to Act No. 15 of 2002 as amended through Act No. 25 of 2003 on Money Laundering): this agency is authorized to request and receive the reports from Financial Service Providers, as well as audit Financial Service Providers regarding their compliance to their obligations according to the provisions of this Act and their adherence to the reporting guidelines about financial transactions.
- Indonesian Deposit Insurance Corporation (LPS): is authorized to obtain the data of customers' saving, bank financial statements and conduct verification and confirmation of data to formulate the policies on the implementation of the blanket guarantee and the executing it.

5. Strategic Goals 1999-2005

The banking policies were focused on numerous attempts to speed up the banking restructuring completion, as well a series of steps to achieve a sound, strong and efficient banking system. The goal was to create a steady financial system to help spur the national economic growth.

The banking policies were focused on numerous attempts to speed up the banking restructuring completion, as well a series of steps to achieve a sound, strong and efficient banking system. The goal was to create a steady financial system to help spur the national economic growth. In addition, the efforts to maximally step up the banking intermediation role were continued, among others by encouraging the banks to concentrate on extending loans to Small and Medium Enterprises (UKM) and Micro Credit Projects (PKM) in compliance to the sound loan disbursement principles.

Meanwhile, the supervision by the State Audit Agency (BPK) and the Capital Market Supervising Agency (Bapepam) remained as it used to be. PPATK which was just set up in 2002 assumed the supervision role by providing quality and useful intelligence information to prevent and curb money laundering and terrorism funding, as well as help create a solid and reliable financial system. While, LPS which was just set up in 2005 was assigned with the supervision role to formulate and set the blanket guarantee policy, and formulate and set the policy to actively take part in maintaining the banking system stability.